LERNER SHOPS

McCRORY-McLELLAN-GREEN STORES

S. KLEIN DEPARTMENT STORES, INC.

GLEN ALDEN CORPORATION

OTASCO-ECONOMY AUTO STORES

ra

RAPID-AMERICAN CORPORATION · ANNUAL REPORT 1964

RAPID-AMERICAN CORPORATION · ANNUAL REPORT 1964

BOARD OF DIRECTORS

ISIDORE A. BECKER
GEORGE V. DELSON
BERNARD KOBROVSKY
LEONARD C. LANE
SAMUEL J. LEVY*
SAMUEL NEAMAN
MESHULAM RIKLIS*
LORENCE A. SILVERBERG*
MURRAY J. TOUSSIE
MEL UNTERMAN
HARRY H. WACHTEL*
JACOB S. WEINSTEIN*

OFFICERS

MESHULAM RIKLIS
Chairman of the Board and President

LEONARD C. LANE
Vice Chairman

SAMUEL J. LEVY
Vice Chairman

HARRY H. WACHTEL
Executive Vice President

LORENCE A. SILVERBERG
Vice President

ANTHONY W. TRAPANI
Vice President and Treasurer

JOSEPH B. RUSSELL
Secretary

COMMITTEE CHAIRMAN

JACOB S. WEINSTEIN . . . . *Executive Committee*
ISIDORE A. BECKER . . . . *Finance Committee*
MEL UNTERMAN . . . . *Option Committee*

*Member of Executive Committee

TO THE SHAREHOLDERS:

As promised in our 1963 report, your management concentrated its major efforts in 1964 in bringing about improved performance of our prime asset, the McCrory Corporation. Details of this improvement are recorded in the accompanying McCrory annual report.

As a result of these successful efforts, Rapid-American Corporation achieved income of $1,950,000 on consolidated sales of $547,775,000, equal to $.93 a share, for the year ended January 31, 1965.

This compares to a loss before special items of $1,601,000 for the comparable period a year ago. Your management believes we have not yet reached a maximum return on our McCrory investment. We are hopeful that further improvement will result from:

- Additional progress of the three McCrory Divisions.
- A growing return on McCrory's investment in 2,388,230 shares of Glen Alden Corporation stock which was purchased last year.
- A return on Lerner Shops' investment in 220,518 shares of S. Klein Department Stores, Inc., which was made on March 17, 1965.
- A generally favorable economic climate in 1965 which is expected to encourage growing retail sales.

The operation of the San Francisco plant continued in a satisfactory manner. In addition, you may be interested to know that your management is actively looking to purchase profitable companies which can add to our earnings picture.

Several changes occurred in our board of directors last year. Leonard C. Lane and Samuel J. Levy were elected vice chairmen of the board. Isidore A. Becker was elected chairman of the finance committee, and Mel Unterman, chairman of the board of the North Shore National Bank of Chicago, was reelected to the board.

At this time we would like to thank our employees and shareholders for their loyalty and help during the year.

Sincerely,

M. Riklis

M. Riklis
Chairman of the Board and President

April 23, 1965

RAPID-AMERICAN

CONSOLIDATED

ASSETS

CURRENT ASSETS:		
Cash (including certificates of deposit, $3,400,000)		$ 13,379,977
Accounts receivable:		
Customers' accounts and equity in installment accounts sold (Note 2)	$ 1,484,500	
Other	2,444,779	
	3,929,279	
Less reserves	1,718,597	2,210,682
Merchandise inventories, at lower of cost or market		86,311,572
Prepaid expenses, etc.		2,139,212
TOTAL CURRENT ASSETS		104,041,443
INVESTMENT IN GLEN ALDEN CORPORATION, at cost (Note 3)		34,258,246
PROPERTY AND EQUIPMENT, at cost	151,596,276	
Less accumulated depreciation and amortization	79,786,320	71,809,956
OTHER ASSETS:		
Excess of purchase cost of investment in consolidated subsidiaries over underlying net equity at dates of acquisition (Note 4)	18,625,172	
Unamortized debt expense	7,805,572	
Investment in and advances to subsidiary not consolidated (Note 1)	5,818,216	
Mortgages and sundry receivables (Note 5)	3,484,903	
Goodwill, less amortization of $326,047	1,026,580	
Deferred charges	1,659,242	38,419,685
TOTAL		$248,529,330

See notes to financial statements.

CORPORATION AND SUBSIDIARIES (NOTE 1)

BALANCE SHEET January 31, 1965

LIABILITIES AND SHAREHOLDERS' EQUITY

CURRENT LIABILITIES:		
Current maturities of long-term debt (Note 6)		$ 12,800,395
Accounts payable		21,200,074
Notes payable		1,538,390
Accrued expenses and sundry liabilities		14,161,491
Accrued Federal income taxes		2,635,000
TOTAL CURRENT LIABILITIES		52,335,350
LONG-TERM DEBT, less current maturities (Note 6)		104,900,210
OTHER NONCURRENT ITEMS:		
Deferred Federal income taxes (Note 7)	$10,662,166	
Reserve for closing or sale of loss stores and discontinuance of credit service (Note 8)	1,303,572	
Other	748,399	12,714,137
MINORITY INTEREST IN SUBSIDIARY COMPANIES		70,069,196
SHAREHOLDERS' EQUITY (per accompanying statement):		
5% cumulative preferred stock, $100 par value per share, redeemable at $105 per share; authorized 200,000 shares, none issued		
Common stock—authorized 10,000,000 shares of $1 par value per share; issued 2,136,243 shares; less stock in treasury 34,536 shares; outstanding 2,101,707 shares (Notes 6 and 10)	2,101,707	
Capital surplus	14,255,307	
Deficit (Note 6)	(6,935,147)	
	9,421,867	
Less equity in subsidiary's cost of its treasury stock	911,430	8,510,437
TOTAL		$248,529,330

See notes to financial statements.

STATEMENT OF CONSOLIDATED INCOME

FOR THE YEAR ENDED JANUARY 31, 1965

NET SALES — Merchandise, restaurant and concession		$547,775,426
INVESTMENT INCOME, EARNINGS OF SUBSIDIARY NOT CONSOLIDATED (NOTE 1), AND MISCELLANEOUS INCOME (Net)		2,243,550
		550,018,976
COST OF GOODS SOLD, BUYING AND OCCUPANCY EXPENSES, NET OF SERVICE CHARGE INCOME (Exclusive of depreciation and amortization)		398,020,843
		151,998,133
DEDUCT:		
Selling, general and administrative expenses (exclusive of depreciation and amortization)	$122,908,929	
Interest charges	9,318,942	
Depreciation and amortization	8,634,634	140,862,505
INCOME BEFORE FEDERAL INCOME TAXES AND EQUITY APPLICABLE TO SHARES OF SUBSIDIARIES IN HANDS OF THE PUBLIC		11,135,628
PROVISION FOR FEDERAL INCOME TAXES (NOTE 7)		4,876,000
INCOME BEFORE EQUITY APPLICABLE TO SHARES OF SUBSIDIARIES IN HANDS OF THE PUBLIC		6,259,628
EQUITY APPLICABLE TO SHARES OF SUBSIDIARIES IN HANDS OF THE PUBLIC		4,309,834
NET INCOME APPLICABLE TO SHAREHOLDERS OF RAPID-AMERICAN CORPORATION (NOTE 12)		$ 1,949,794

See notes to financial statements.

CORPORATION AND SUBSIDIARIES (NOTE 1)

STATEMENT OF SHAREHOLDERS' EQUITY

FOR THE YEAR ENDED JANUARY 31, 1965

	Outstanding Common Stock	Capital Surplus	Earned Surplus (Deficit)	Equity in Subsidiary's Cost of its Treasury Stock
BALANCE, FEBRUARY 1, 1964	$2,101,707	$14,252,903	$(4,571,769)	$(1,103,178)
ADD (DEDUCT):				
Net income per accompanying statement of consolidated income (Note 12)			1,949,794	
Provision in settlement of certain legal actions, net (Note 13)			(507,040)	
Equity in certain transactions of subsidiaries exclusive of amounts included in two items next above:				
Charge to establish reserve for the closing or sale of loss stores and discontinuance of credit service, net of estimated Federal income tax benefit (Note 8)			(1,785,350)	
Provision for estimated additional taxes and other adjustments applicable to prior years (Note 13)			(1,107,819)	
Other		2,404	(912,963)	191,748
BALANCE, JANUARY 31, 1965	$2,101,707	$14,255,307	$(6,935,147)	$ (911,430)

See notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

(1) Principles of consolidation:

The accompanying consolidated financial statements as of January 31, 1965, reflect the consolidation of Rapid-American Corporation and its subsidiaries including McCrory Corporation (whose common stock is 50.9% owned by Rapid). The McCrory consolidated financial statements reflect the consolidation of Lerner Stores Corporation (whose common stock is 99% owned by McCrory) and all wholly-owned subsidiaries except McCrory Credit Corporation. The investment in the credit subsidiary not consolidated is stated in the accompanying consolidated balance sheet at the amount of McCrory's equity in the capital and undistributed earnings ($918,528) of such subsidiary at January 31, 1965. McCrory's equity in the net income ($365,088) of the nonconsolidated credit subsidiary for the year ended January 31, 1965, is included in the accompanying statement of consolidated income. (See Note 2 for additional information on McCrory Credit Corporation.)

Dividends received by Rapid from McCrory amounted to $2,129,014 for the year ended January 31, 1965.

(2) Equity in installment accounts sold:

The companies have financing agreements with McCrory Credit Corporation (see following paragraph) under which certain customers' accounts receivable created each month are assigned to McCrory Credit Corporation. The latter remits 90% of the amount of accounts assigned, the remaining 10% representing the companies' equity therein. The companies accept reassignment of any accounts in default, as defined. The companies' equity in assigned accounts receivable (the uncollected balances of which amount to $27,560,000 at January 31, 1965) is included in accounts receivable in the accompanying consolidated balance sheet. Collections in January 1965 (payable to McCrory Credit Corporation in February 1965) from assigned customers' accounts (net of 10% equity) amounting to $7,350,000 have been deducted from accounts receivable in the accompanying consolidated balance sheet.

McCrory Credit Corporation, a wholly-owned subsidiary of McCrory Corporation, was organized to (a) accept the assignment of accounts receivable from McCrory Corporation and subsidiaries and affiliates as outlined in the preceding paragraph and (b) through a separate leasing subsidiary, to acquire equipment for lease to the McCrory-McLellan-Green Stores Division of McCrory under a 15 year lease agreement. At January 31, 1965 the credit corporation and its subsidiaries had invested $27,560,000 in accounts receivable of McCrory and its subsidiaries and affiliates and an additional $1,325,000 in equipment purchased for rental. Financing of the foregoing had been provided principally from (1) $1,000,000 of equity funds and $4,000,000 in subordinated loans from McCrory Corporation and subsidiaries, (2) $22,000,000 in 4½% bank loans on unsecured notes of the credit corporation, and (3) a 5½% chattel mortgage with a balance of $1,286,000 at the year end.

(3) Investment in Glen Alden Corporation:

During the year ended January 31, 1965 McCrory acquired 2,388,230 common shares of Glen Alden Corporation for cash and notes payable. These shares represent 49.7% of the outstanding common shares of Glen Alden Corporation at January 31, 1965 and had a market quotation value of $28,957,289 at that date and $32,838,163 at March 23, 1965. McCrory's equity in the net assets of Glen Alden Corporation based on its financial statements as of December 31, 1964 was $844,290 in excess of the cost of the investment. Dividends of $674,073 received in January 1965 from Glen Alden have been included in investment income in the accompanying statement of consolidated income.

(4) Excess purchase cost of Lerner Stores Corporation common stock and McCrory Corporation common stock:

Rapid's cost of its investment in McCrory at date of acquisition (September 30, 1962) was in excess of its equity in the net assets of McCrory in the amount of $1,549,984.

During 1961 and 1962, McCrory acquired 1,263,617 shares (99% ownership as of January 31, 1965) of Lerner Stores Corporation common stock principally as the result of a tender offer made on August 10, 1961. The aggregate cost of the investment in Lerner exceeded the McCrory equity in underlying Lerner net assets at dates of acquisition by $17,075,188.

The foregoing excess purchase costs have been recognized by the managements of Rapid and McCrory as being similar in nature to intangibles which have not declined in value since dates of acquisition. Accordingly, the managements of Rapid and McCrory have adopted an accounting policy of not amortizing these excess purchase costs, so long as there is no recognized diminution in value of the related investments.

(5) Mortgages and sundry receivables:

Under certain circumstances receivables aggregating $800,000, arising in the sale of certain assets, may be settled by the payment to Rapid of 80,000 shares of its common stock.

(6) Long-term debt:

Long-term debt at January 31, 1965, including maturities due within one year, consisted of the following:

	Total	Current Maturities	Long-Term Debt
7% sinking fund subordinated debentures, due November 15, 1967, less debentures in treasury $120. (a)	$ 2,250,584		$ 2,250,584
5¾% convertible subordinated debentures, due January 1, 1977, less debentures in treasury $250,000. (b)	12,949,940		12,949,940
5½% sinking fund subordinated debentures, due 1976 (c) . . .	36,040,960		36,040,960
5%-6% notes, due 1966 to 1976 (d) . . .	22,575,000		22,575,000
5.235% subordinated notes, due in equal annual installments to 1971	12,503,991	$ 1,786,284	10,717,707(e)
5% junior subordinated notes maturing serially from April 1, 1965 to April 1, 1970, less notes in treasury $335,350	24,144,008	10,411,685	13,732,323(e)
3% sinking fund debentures due July 1, 1967, less debentures in treasury $525,000 (f)	3,275,000	75,000	3,200,000
Mortgages payable . .	2,230,431	125,446	2,104,985
Other	1,730,691	401,980	1,328,711
Total	$117,700,605	$12,800,395	$104,900,210

(a) Exclusive of $1,530,608 exchanged and cancelled which will be used to satisfy 1965 and 1966 sinking fund payments.

(b) Of these debentures, $500,000 principal amount is subject to change under certain circumstances. The issued debentures are convertible into common stock of Rapid at $27.99 principal amount of debentures for each share of common stock, subject to anti-dilution provisions of the indenture, and are callable upon notice at principal amount with interest to redemption date.

(c) Exclusive of $831,104 redeemed and cancelled which is available for 1968 sinking fund payment. Sinking fund requirements in each year are as follows: 1968 through 1971 — $2,048,448; 1972 through 1976 — $3,277,517, with a final payment of $12,290,687 due on August 15, 1976.

(d) These notes are collateralized by the pledge of 2,661,268 shares of McCrory Corporation common stock which are owned by Rapid. Rapid's investment in McCrory common stock at January 31, 1965 aggregated 2,661,268 shares (50.9% of the outstanding common stock of McCrory Corporation). The acquisition cost of these shares to Rapid was $46,453,938 and such shares are carried on Rapid's books at $45,300,757 on January 31, 1965, representing Rapid's portion of McCrory common stock equity at that date. Such shares had a market quotation value of $41,582,312 at January 31, 1965 and $50,896,750 on March 25, 1965.

(e) By notices dated March 1 and 8, 1965, McCrory called for redemption on March 30 and April 1, 1965, $5,368,630 of the foregoing debt which is classified as long-term at January 31, 1965. The $5,368,630 has been retained in long-term debt at January 31, 1965 since it is the intention of McCrory's management to pay such debt by utilization of long-term borrowings.

(f) Sinking fund requirements are $600,000 in each year to 1966 and $2,600,000 at maturity.

Agreements covering certain long-term debt of Rapid contain covenants concerning working capital position, additional indebtedness, limitations on the declaration and payment of dividends, restrictions on transactions in capital stock, etc. At January 31, 1965, there was no earned surplus available for the payment of dividends. In January 1964, Rapid entered into an agreement (amended in July 1964) which extended the payment dates on portions of its indebtedness and waived the working capital restrictions until July 31, 1966.

The aggregate of long-term debt maturing during the five years ended January 31, 1970 is approximately as follows: 1965, $12,800,000 (included in current liabilities); 1966, $23,030,000; 1967, $11,384,000; 1968, $5,299,000; and 1969, $6,296,000.

Interest charges incurred by Rapid amounted to $2,300,722 for the year ended January 31, 1965.

(7) Federal income taxes:

The provision for Federal income taxes in the accompanying consolidated statement of income is applicable in its entirety to McCrory and its subsidiaries. Such provision is based upon McCrory's filing a consolidated Federal income tax return and has been reduced by McCrory's carry-forward consolidated operating loss and its investment tax credit. At January 31, 1965, McCrory and its subsidiaries have an unused investment tax credit of approximately $900,000.

For Federal income tax purposes McCrory and its subsidiaries utilize accelerated methods of computing depreciation and the installment method of reporting certain sales. The use of these methods has resulted in tax deferrals which have been charged against income and credited to deferred Federal income taxes.

(8) Reserve for the closing or sale of loss stores and discontinuance of credit service:

On May 28, 1964 the McCrory Board of Directors established through a charge of $3,500,000 (net of estimated Federal income tax benefit) to earned surplus, a reserve for losses principally inherent, although not yet realized, in the planned termination of operations of loss stores and discontinuance of credit service at certain stores. Rapid's equity in such charge is $1,785,350. In the year ended January 31, 1965, charges totaling $2,196,428, net of Federal income taxes, were made to this reserve.

(9) McCrory-preferred and preference stock and warrants:

At January 31, 1965, there were 522,915 shares of McCrory common stock reserved for the conversion of McCrory preferred and preference stock.

In addition, 2,673,467 shares of McCrory common stock were reserved for the exercise, at $20 per share, of warrants (expiring in 1976) issued in connection with the 1961 merger of H. L. Green and the 1961 purchase of Lerner stock.

(10) Common stock:

A qualified stock option plan adopted by the Board of Directors of Rapid-American Corporation on August 27, 1964 and amended on March 24, 1965, subject to stockholders' approval, authorized the grant to officers, other executive and key employees of options to purchase 100,000 shares of common stock at 100% of the fair market value on the dates of grant. Options to purchase 28,200 shares at $10.125 a share were granted on February 1, 1965 and 71,800 shares remain available for future option grants under this plan.

Options covering 110,805 shares of Rapid-American Corporation common stock outstanding at January 31, 1964 were cancelled during the year.

At January 31, 1965, purchase warrants entitling their holders to purchase 400,000 shares of Rapid's common stock at $5 per share were outstanding, of which 300,000 expire on January 2, 1968 and 100,000 expire on June 1, 1976. The terms of these warrants are subject to adjustments under certain circumstances.

Under McCrory restricted stock option plans, adopted during 1960 and 1961, options for 490,700 shares of McCrory common stock were outstanding at January 31, 1965 at prices ranging from $11.91⅓ to $22.80 per share (375,700 shares at 95% and 115,000 shares at 100%, of fair market value on dates of grant), of which 304,920 shares were exercisable at that date. During the year ended January 31, 1965, options for 104,070 shares became exercisable; 9,060 shares were exercised at an aggregate option price of $111,722; options to purchase 115,000 shares at $12.25 a share were granted; and, options for 407,200 shares were cancelled. At January 31, 1965, 526,820 shares remain available for future option grants under these plans. It is contemplated that, if the 1964 qualified stock option plan of McCrory noted below is approved by stockholders, no future options will be granted under the aforesaid McCrory plans.

A qualified stock option plan adopted by the Board of Directors of McCrory Corporation during 1964, subject to stockholders' approval, authorized the grant to officers, other executive and key employees of options to purchase up to 750,000 shares of McCrory common stock at 100% of the fair market value on the dates of grant. Options to purchase 389,300 shares have been issued under this plan (including options to purchase 1,200 shares cancelled) at prices ranging from $13.125 to $14.50 a share. At January 31, 1965, options as to 388,100 shares were outstanding, of which 96,023 shares, subject to McCrory stockholders' approval of the plan, were exercisable at that date; 361,900 shares remain available for future option grants under this plan.

The option granted by McCrory on January 31, 1964 to a key employee to purchase 15,000 shares of its common stock held in the treasury, at a price of $13.50 per share, was cancelled on July 1, 1964.

McCrory has employee stock purchase plans, adopted during 1960 and 1961, which permit the grant of rights to purchase a total of 190,000 shares of common stock at 85% of the fair market value thereof on the dates of grant. Rights to purchase 13,826 shares were exercised during the year at an aggregate purchase price of $159,209 and at January 31, 1965, 14,533 shares were under subscription at prices ranging from $10.63 to $14.24. No additional rights will be issued under the aforesaid stock purchase plans.

(11) Pension plans:

McCrory has a noncontributory retirement plan which covers eligible employees of the McCrory-McLellan-Green Stores Division, the cost of the plan will be met, as required, by periodic contributions to the trust fund. The amounts accumulated in the trust fund in respect of the McCrory-McLellan-Green plan, exceed the actuarial liability as computed by the consulting actuary. For this reason, no provision for costs under this plan was reflected in the statements of consolidated income subsequent to 1960. Contributions of $1,000,000 made under other noncontributory retirement and profit sharing plans, principally for employees of Oklahoma Tire and Supply and Lerner Stores Corporation, paid or accrued during the year, have been reflected in the accompanying statement of consolidated income.

(12) Net income and earned surplus (deficit):

The charge to establish a reserve for the closing or sale of loss stores and discontinuance of credit service ($1,785,350), provision for estimated additional taxes and other adjustments applicable to prior years ($1,107,819), and estimated provision in settlement of certain legal actions, net ($507,040) included in the accompanying statement of shareholders' equity are being set forth as special items following net income in reports filed with the Securities and Exchange Commission.

(13) Other matters:

Federal income tax returns of Lerner Stores Corporation and subsidiaries for the fiscal years ended in 1958, 1959 and 1960 have been examined by the Internal Revenue Service and there has been tentative agreement with the Internal Revenue Service regarding settlement of the outstanding issues. The companies have provided, by a charge of $2,200,000 (Rapid's equity therein is $1,107,819) to earned surplus, for the estimated effect of such tentative agreements, together with provisions for other taxes and adjustments which relate to prior years.

In January 1965, Rapid-American Corporation agreed to the proposed settlement of certain derivative actions, including those pending in the New York County Supreme Court, subject to review and approval of that Court, by payment to McCrory Corporation of $800,000. Such payment, at the option of Rapid, may be made in cash or in McCrory Corporation common stock or in both. Rapid has provided for the proposed settlement by a charge of $507,040 to earned surplus (deficit) which consists of the $800,000 less Rapid's equity in the amount to be realized by McCrory.

There are several claims pending against the Company and its subsidiaries together with other contingencies. Such liability cannot be determined but management and counsel are of the opinion that the liabilities in the accompanying consolidated financial statements are adequate to cover all eventual payments.

At January 31, 1965, the minimum annual rentals upon property leased to the Company and its subsidiaries under leases expiring after January 1968, amount to approximately $22,200,000 plus, in certain instances, real estate taxes, insurance, etc. Of total rental obligations, approximately $436,000 is related to two leases on locations at which operations have been discontinued. No specific provision has been made in the accompanying consolidated financial statements for future payments to be made on these two leases because it is the opinion of the management of Rapid that such payments will be immaterial in amount.

On March 17, 1965, an interest of approximately 19% in the common stock of S. Klein Department Stores, Inc. was acquired by Lerner Stores Corporation at a cost of approximately $3,350,000.

ACCOUNTANTS' OPINION

Rapid-American Corporation:

We have examined the financial statements of Rapid-American Corporation and subsidiaries except Lerner Stores Corporation and its subsidiaries for the year ended January 31, 1965. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. As to Lerner Stores Corporation and its subsidiaries, we were furnished with the report of other accountants on their examination of the financial statements of that company and its subsidiaries for the year.

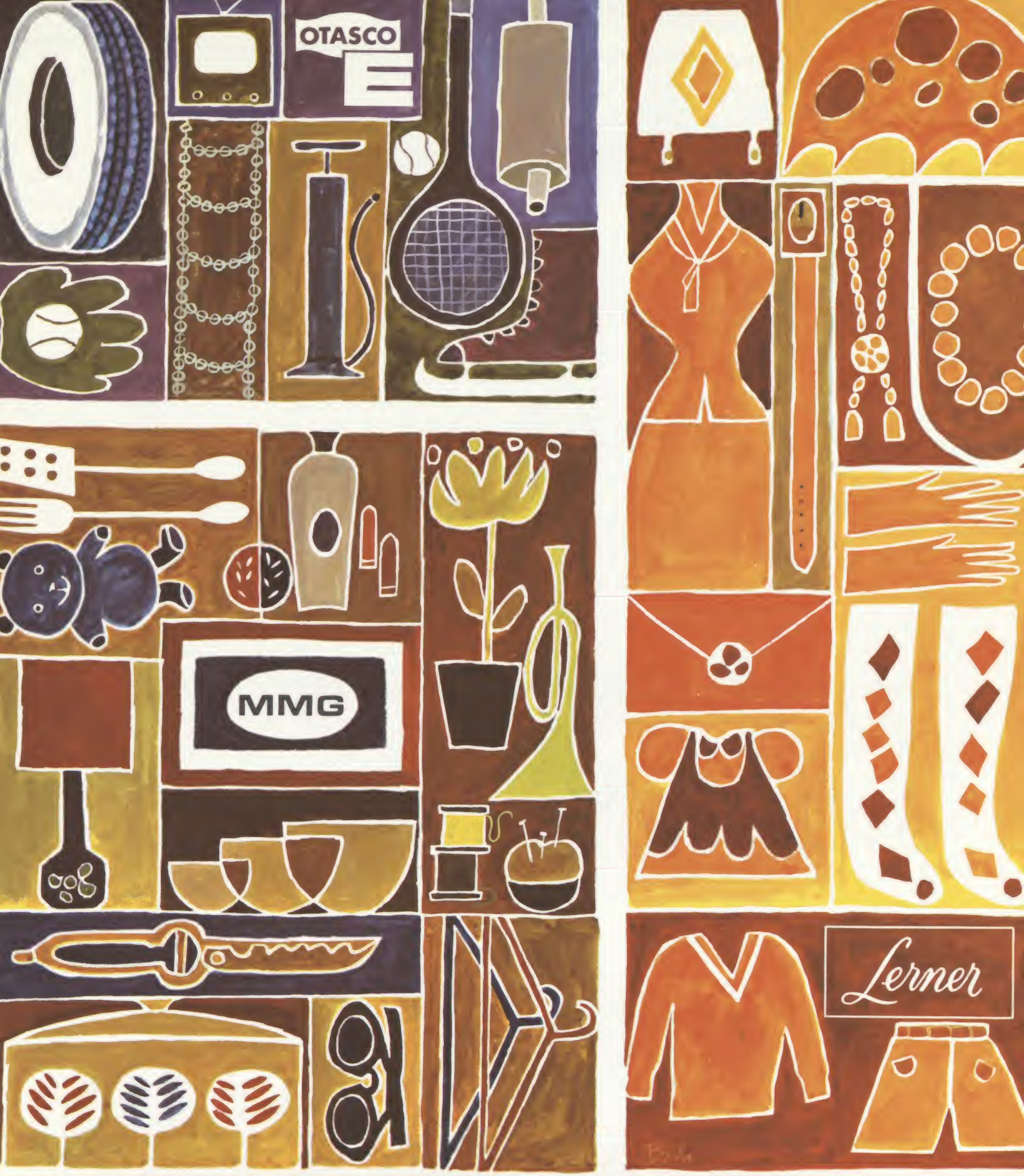
In our opinion, based on our examination and the report of other accountants referred to above, the accompanying consolidated balance sheet and statements of consolidated income and shareholders' equity present fairly the financial position of Rapid-American Corporation and subsidiaries at January 31, 1965 and the results of their operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

HASKINS & SELLS
Certified Public Accountants

New York, N. Y.
March 25, 1965

AUDITORS	HASKINS & SELLS, NEW YORK, N. Y.
GENERAL COUNSEL	WACHTEL & MICHAELSON, NEW YORK, N. Y.
TAX ADVISORS	HANIGSBERG, DELSON & BROSER, NEW YORK, N. Y.
TRANSFER AGENTS	CHEMICAL BANK NEW YORK TRUST COMPANY, NEW YORK, N. Y. THE FIRST NATIONAL BANK OF JERSEY CITY, JERSEY CITY, N.J.
REGISTRAR	THE CHASE MANHATTAN BANK, NEW YORK, N. Y.
LISTINGS	AMERICAN STOCK EXCHANGE (Common Stock & Debentures) CINCINNATI STOCK EXCHANGE (Common Stock)

EXECUTIVE OFFICES 711 FIFTH AVENUE, NEW YORK, N. Y. 10022



McCRORY CORPORATION · ANNUAL REPORT 1964

McCRORY-McLELLAN-GREEN STORES · LERNER SHOPS · OTASCO-ECONOMY STORES

BOARD OF DIRECTORS

Isidore A. Becker	*Harold M. Lane Sr.	Samuel Neaman	*Leonard Spangenberg
Patrick J. Clifford	Harold M. Lane Jr.	*Gilbert H. Perkins	Mel Unterman
Albert N. Greenfield	*Leonard C. Lane	*Bert R. Prall	*Harry H. Wachtel
Bernard Kobrovsky	Seymour Lazar	*Meshulam Riklis	Hugh C. Ward
Stanley H. Kunsberg	Samuel J. Levy	Julius Sanditen	*J. S. Weinstein
	Albert A. List	Lorence A. Silverberg	

*Member of Executive Committee

OFFICERS

Meshulam Riklis
Chairman of the Board and President

Leonard C. Lane
Vice Chairman

Harold M. Lane Sr.
Vice Chairman

Samuel Neaman
Executive Vice President

Harold M. Lane Jr.
Executive Vice President

Julius Sanditen
Executive Vice President

Harry H. Wachtel
Executive Vice President

Stanley H. Kunsberg
Executive Vice President

Isidore A. Becker
Financial Vice President & Treasurer

Bruce Jacobi
Vice President, Real Estate

Ely Sanditen
Vice President

Seymour Greene
Secretary

Haim Bernstein
Assistant to the President

DIVISION PRESIDENTS

Stanley H. Kunsberg
Lerner Shops

Samuel Neaman
McCrory-McLellan-Green Stores

Julius Sanditen
Otasco-Economy Auto Stores

COMMITTEE CHAIRMEN

Leonard Spangenberg	*Executive Committee*
Bernard Kobrovsky	*Salary and Compensation Committee*
Gilbert H. Perkins	*Stock Option Committee*
J. S. Weinstein	*Acquisition and Diversification Committee*

AUDITORS	Haskins & Sells, New York, N. Y.	
GENERAL COUNSEL	Wachtel & Michaelson, New York, N. Y.	
TAX ADVISORS	Hanigsberg, Delson & Broser, New York, N. Y.	
PUBLIC RELATIONS	Rubenstein, Wolfson & Co., New York, N. Y.	
TRANSFER AGENTS	Common Stock 5½% Preference B Stock 4½% Preference B Stock	Chemical Bank New York Trust Company and First National Bank of Chicago
	3½% Preferred Stock $6 Preference Stock	Morgan Guaranty Trust Company of New York and First National Bank of Chicago
REGISTRARS	Common Stock 5½% Preference B Stock	Morgan Guaranty Trust Company of New York and Continental Illinois National Bank and Trust Company of Chicago
	4½% Preference B Stock	The Chase Manhattan Bank and Continental Illinois National Bank and Trust Company of Chicago
	3½% Preferred Stock $6 Preference Stock	Chemical Bank New York Trust Company and Continental Illinois National Bank and Trust Company of Chicago

EXECUTIVE OFFICES 711 Fifth Avenue, New York, N. Y. 10022

McCRORY CORPORATION

ANNUAL REPORT FOR THE YEAR ENDED JANUARY 31, 1965

Financial Highlights

	1964	1963
Net sales	$547,433,000	$569,116,000
Net earnings	$ 8,666,000	$ 4,665,000*
Net earnings per share	$ 1.41	$ .64 *
Cash generated from operations	$ 22,000,000	$ 16,000,000
Cash generation per share	$ 4.00	$ 2.80
Return on common equity	8.3%	3.7%
Number of stores	1,323	1,554
Number of common shares outstanding	5,228,867	5,210,396

*including special credit—net

The Annual Meeting of Stockholders will be held at the York Distribution Center, 2955 East Market St., York, Pennsylvania, on Tuesday, May 25, 1965, at 2:00 p.m. local time. Each stockholder entitled to vote thereat will receive by mail a formal notice of meeting, together with proxy statement and form of proxy, on or about May 4, 1965, at which time proxies will be solicited by order of the Board of Directors.

TO THE SHAREHOLDERS:

M. Riklis

It is with much gratification that I report to you the substantial progress your company made in 1964. McCrory earned $8,666,000, equal to $1.41 per share, on sales of $547,433,000. This compares with earnings of $4,665,000 (including special items), equal to $.64 per share, on sales of $569,116,000 for 1963.

Our 1964 sales increased 2.65% over 1963, after adjustments made to reflect the disposition of National Shirt and Mobile Divisions.

Depreciation and amortization charged to operations amounted to $9,473,000 or $1.81 per share. Cash generated during the year from operations was $22,000,000, or $4.00 per common share (after preferred and preference dividends), compared to $16,000,000 or $2.80 per share the previous year.

Common stock dividends paid in 1964 were $.80 per share. In view of the company's strong earnings trend and financial position, the board of directors voted in February 1965 to increase the regular quarterly common stock dividend to $.25 per share. An extra dividend of $.20 per share was declared on March 24, 1965.

In May 1964, we renewed our $50,000,000 revolving credit agreement with our banks for a two-year period. Peak seasonal borrowings under this agreement in 1964 were $35,000,000 and all loans were repaid December 29, 1964. We did not again avail ourselves of this credit until March of 1965, notwithstanding cash payments of $9,553,000 made in connection with the acquisition of Glen Alden Corporation common stock.

Capital expenditures for the year totaled $4,751,000 compared with $6,510,000 in 1963 and were used primarily for the opening of new stores and the rehabilitation of older units.

Long-term debt, exclusive of the newly issued subordinated notes for the acquisition of Glen Alden common stock, was reduced by $2,564,000 in 1964 and by $17,390,000 since January 1962.

Operations

We can be exceedingly proud of the results of our operating divisions and I am sure that all shareholders will join in congratulating the employees and management teams of the three divisions—Lerner Shops, McCrory-McLellan-Green Stores (MMG) and OTASCO-Economy Auto Stores—for their effort and dedication in making 1964 a milestone in progress and a basis for further growth and increased profits.

Lerner Shops further increased its profits to a peak surpassed only once, in 1948.

OTASCO-Economy Auto Stores continued to set new records in sales and profits.

MMG, under the presidency of Samuel Neaman, has rallied to achieve a most spectacular recovery, with profits before taxes in excess of $7,500,000. In my opinion it will move to still higher levels.

Acquisitions

In late 1964 and early 1965 McCrory acquired 2,388,230 common shares of Glen Alden, representing 49.7% of the outstanding common stock of Glen Alden. For your convenience, financial highlights and a description of Glen Alden are provided on the inside back cover.

On March 17, 1965, Lerner Shops purchased 220,518 shares of the S. Klein Department Stores, Inc. This is approximately 19% of the outstanding common stock of S. Klein. Additional information about S. Klein is included

on page 5 and the inside back cover.

We believe that both these moves will further enhance our growth and will provide a wider base for increased profits.

Management

On March 24, 1965 your board of directors elected the undersigned to the additional post of president and chief executive officer. Harold M. Lane Sr. was elected a vice chairman. Samuel Neaman, Julius Sanditen and Stanley H. Kunsberg were elected executive vice presidents and Ely Sanditen was elected a vice president.

We welcome to our board Albert A. List, chairman of Glen Alden and Hugh C. Ward, recently retired vice president of the First National Bank of Boston, now with Clark Dodge & Co., Inc., investment bankers.

We welcome back as directors, Mel Unterman, chairman of the North Shore National Bank, and Julius Sanditen, president of OTASCO-Economy Auto Stores.

Outlook

The past year has seen a record economic boom which greatly benefited the retail trade and, therefore, your company's fortunes too. Your management believes that all indicators suggest another good year in 1965 and that we should, therefore, see further improvement in our results. In addition to the above favorable factors, there are other reasons why I believe we can look with great anticipation to McCrory's results in the coming year.

MMG, the variety division, is yet to reach its full potential under its new leadership. New and improved merchandising, along with greatly improved working conditions and compensation structure, have greatly enhanced morale and, therefore, the prospects of this division.

Lerner Shops continues its expansion which promises further improvements.

OTASCO-Economy Auto Stores launched its biggest expansion program ever and also has been searching for possible acquisitions for further growth.

Conclusion

I would like to conclude by personally thanking your board of directors and also your top operating team—Harold Lane Sr., Leonard C. Lane, Samuel Neaman, Stanley Kunsberg, Julius Sanditen, Isidore Becker and Harold Lane Jr.—for their undivided devotion to the performance of their duties and the consequent gratifying results of the year.

May I express our appreciation to our banking friends at our major institutions—Chemical Bank New York Trust Company, The Chase Manhattan Bank, The First National Bank of Boston and Franklin National Bank—and all the other banks throughout the country that serve our stores, for their advice and support.

I also would like to thank our suppliers, shareholders and employees for their help and loyalty throughout the year.

Sincerely,

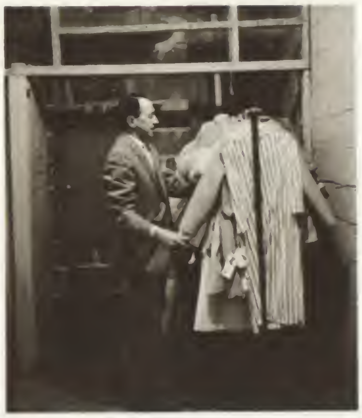
M. Riklis

M. Riklis
Chairman of the Board and President

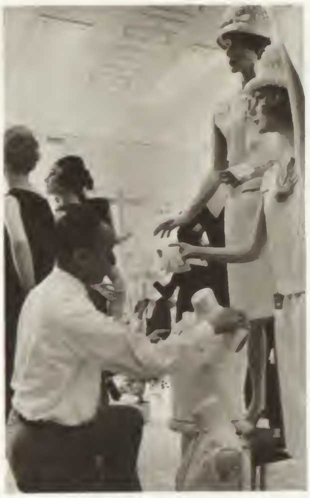
April 22, 1965

LERNER SHOPS DIVISION

Hard work and careful preparation
behind the scenes
are the necessary prelude to a sale



Merchandise moves from stockroom



Window display is arranged

A coat is ticketed

Counter is replenished

A sale is made

Lerner Shops achieved the highest volume in its 46 year history in 1964 and the highest profits in recent years.

During the year, nine new Lerner Shops and two new Lanes stores were opened. Seven of the new Lerner Shops are in important suburban shopping centers. The remaining two are in Puerto Rico, bringing the number of stores in operation on that island to eight. The two Lanes stores are in shopping centers in Poughkeepsie, N.Y., and suburban St. Louis, Mo.

Major improvements were completed in eleven stores and substantial improvements made in many others, in line with our policy of constant modernization. During the year, four outmoded stores were closed in cities where it was deemed uneconomical to continue operations. Construction was begun to replace four stores in cities where increased volume justified larger and more modern facilities.

Management concentrated on the increased development and utilization of our large scale computer installation, which facilitates our merchandising, accounting and the flow of information between our New York home office and our five operating centers located in Los Angeles, Cal.; Atlanta, Ga.; Denver, Colo.; Chicago, Ill.; and Jacksonville, Fla.

Following the acquisition in March 1965 of approximately 19% of the outstanding shares of S. Klein Department Stores, Inc., Harold M. Lane Sr., chairman of Lerner Shops, was elected chairman and chief executive officer of S. Klein, and Harold M. Lane Jr., executive vice president of Lerner Shops, was elected vice chairman of Klein. Lerner Shops and McCrory Corporation will put their full financial strength and talent behind Klein in its program of growth and improvement, which will include expansion through new stores.

At the end of 1964, there were 330 Lerner Shops and five Lanes stores in operation in 39 states, the District of Columbia and Puerto Rico.

Our 1965 expansion program gives priority to new stores in suburban shopping centers and to the modernization of downtown stores in cities whose urban development is expanding. A sixth Lanes store is now under construction in Flushing, N. Y. This store will occupy 176,000 square feet in what is considered an unusually busy shopping area.

DIVISION OFFICERS

HAROLD M. LANE SR. *Chairman of the Board of Directors*
STANLEY H. KUNSBERG .... *President*
HAROLD M. LANE JR. .... *Executive Vice President*
HAROLD F. MILLER. . *Senior Vice President and Secretary*
D. JOHN PALLADINO ...... *Vice President and Treasurer*
BENJAMIN J. TIMONER .... *Vice President*
MILTON SEEGAL .... *Vice President*
ROBERT L. KRILL .... *Vice President*
HAROLD GREENE .... *Vice President*
EUGENE SHAW .... *Vice President*
MELVIN J. REDMOND .... *Vice President*
KARL MARGOLIS .... *Vice President*
NATHAN B. EPSTEIN .... *Vice President*
SAMUEL S. BRAND .... *Vice President*
DAVID D. GREENWALD .... *Vice President*
BRUCE A. JACOBI .... *Vice President*
EUGENE D. FRANK .... *Vice President*
JACOB J. SCHER .... *Vice President*
MAX J. MILLER .... *Vice President*

OFFICE: 354 PARK AVENUE SOUTH, NEW YORK, N. Y.

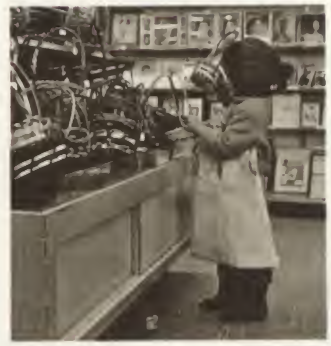
Lerner Shops top management (left to right) Stanley H. Kunsberg, president; Harold M. Lane Sr., chairman; and Harold M. Lane Jr., executive vice president.

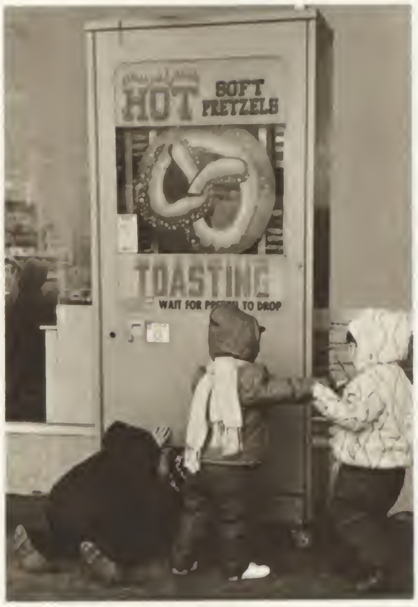
McCRORY-McLELLAN-GREEN STORES DIVISION

An M.M.G. Variety Store
is many things to many people

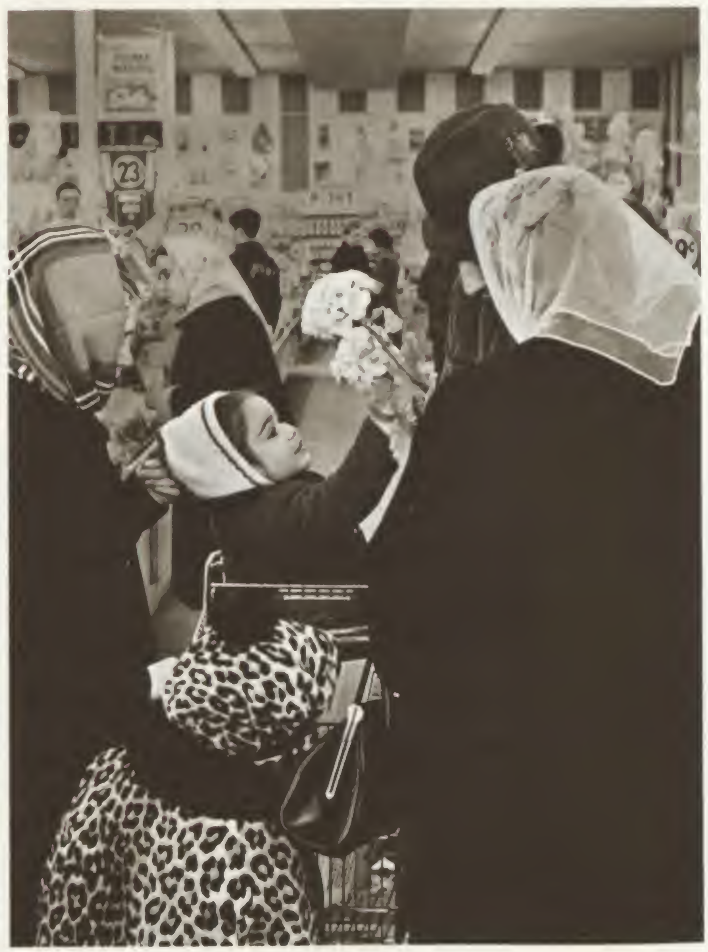
Springtime

Business decision

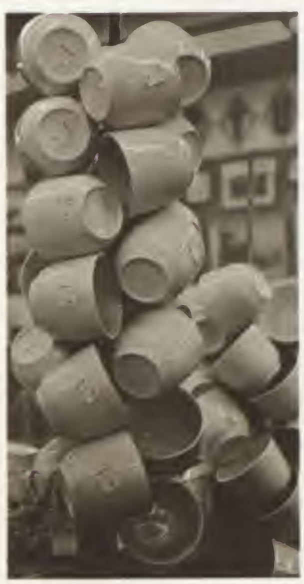




Exploration



Togetherness



Non-objective art

Search for glamour

This was a year of achievement.

McCrory-McLellan-Green Stores (MMG) returned to the basic business for which it was organized—operating variety stores.

Under the leadership of Samuel Neaman, who was elected to the presidency in mid-year, the division concentrated its efforts on decentralizing field operations, strengthening over-all management organization, up-grading stores and closing unprofitable outlets where necessary.

In line with this policy, 35 unprofitable stores were closed, while three new ones were opened and many redecorated.

Model stores were established in every district of the division as a proving ground for merchandising concepts generated by our buying staff and field organization. Numerous new merchandising ideas that raised profits and cut costs were thus developed and used throughout the chain.

A new decentralization program provided strong operating staffs in the six regions of the division. Closer cooperation and coordination of all stores occurred with the end result being increased customer satisfaction.

The operation of the York Distribution Center (Pennsylvania) was improved, making it possible to service all of our stores from this point. This more efficient means of supplying merchandise to stores increased stock turnover and permitted a substantial inventory reduction.

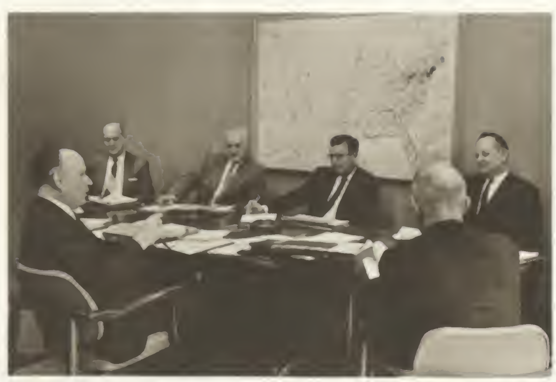
Emphasis was placed on the rebuilding of our organization from within, with each individual being given opportunity to develop his fullest potential. This improved employee morale to the level where profit incentives earned in 1964 were far greater than in 1963 and contributed to the increased earnings of the division.

At year end we operated 564 stores. We look forward to 1965 as a year of growth, based on the firm foundation laid in 1964. We plan to expand the number of stores within the division and to carry forward the improvement so well begun during the past year.

DIVISION OFFICERS

S. NEAMAN .... *President*
L. A. SILVERBERG .... *Director of Concessions*
L. C. SHOCKLEY .... *Senior Vice President and Assistant to the President*
J. F. KING .... *Senior Vice President*
W. SHULDINER .... *Vice President*
R. O. KRISTIANSEN .... *Vice President*
T. B. ACKER .... *Vice President—Mid-Atlantic*
N. G. BAILEY .... *Vice President—Mid-West*
C. F. CARTER JR. .... *Vice President—East Central*
F. C. GARDNER .... *Vice President—Southeast*
N. S. MCBRAYER .... *Vice President—Southwest*
N. P. MCLUCKIE .... *Vice President—Northeast*

OFFICE: 31-39 WEST 34 STREET, NEW YORK, N. Y.



S. Neaman, president, and L. C. Shockley, senior vice president, (left to right, back to the camera) confer with regional vice presidents (left to right) N. G. Bailey, N. P. McLuckie, F. C. Gardner and N. S. McBrayer.

OTASCO-ECONOMY AUTO STORES DIVISION

Salesman helps young couple select furniture

Merchandise is checked-in at new Atlanta distribution center

Repair facility complements auto parts and accessory sales

This division achieved record sales and profit in 1964 in the face of what proved to be one of the most competitive years in its 47 year history.

A major undertaking during the year was the further integration and expansion of the Economy Auto Stores operation acquired in 1961. This included the coordination of such functions as purchasing, merchandising and personnel with headquarters' policies and techniques.

In order to help Economy achieve its substantial growth potential, a new ultra-modern warehouse and office facility was completed in College Park, a suburb of Atlanta, Georgia. This new distribution center is capable of serving some 60 Economy-owned stores and 150 franchised associate dealers. This is approximately double the present Economy operation in its four state area. Sales of Economy have increased 60% since it was acquired by OTASCO.

In the division as a whole, six new stores were opened last year, bringing the total to 134. Six stores were remodeled as part of the continuous up-grading of all operations. The division's associated franchise stores numbered 262 at year end. Important enlargements were completed at the distribution centers in Tulsa, Oklahoma and Little Rock, Arkansas.

Throughout the year a number of effective, creative sales promotions were conducted throughout the chain, built around emphasis on salesmanship and personal service. Numerous new credit accounts were opened, providing new loyal customers, store traffic and extra profits.

The improvement of employee benefits, goodwill and know-how was intensified. New and better training programs were conducted, major job promotions continued to be made from within, and talented new employees were added to starting positions in the division.

The division looks forward to continued progress in 1965. The general market for the division's product line—auto accessories and parts, home appliances, housewares and sporting goods —has never been better. The territories where the division operates are enjoying unprecedented growth. In response to this opportunity, an impressive new store program already is underway. In addition, the division is actively looking to acquire other healthy compatible retail chains.

DIVISION OFFICERS

MAURICE SANDITEN . . *Chairman of the Board of Directors*
JULIUS SANDITEN . . . . . *President*
ABE BRAND . . . . . *Executive Vice President*
ELY SANDITEN . . . . . *Senior Vice President*
EDGAR R. SANDITEN . . . . . *Vice President*
A. A. MCNATT . . . . . *Vice President*
JOHN R. BEHL . . . . . *Vice President*
EDWARD WILKONSON . . . . . *Vice President*
SAMUEL H. MINSKY . . . . . *Secretary*
HERMAN SANDITEN . . . . . *Treasurer*

OFFICE: 6901 EAST PINE STREET, TULSA, OKLAHOMA

Otasco-Economy headquarters staff meeting, (left to right) Mark Colburn, manager accounting department; Ely Sanditen, senior vice president; Irving Fenster, sales promotion manager; A. A. McNatt, vice president, retail store operations; Julius Sanditen, president; Edgar Sanditen, vice president, merchandising; and M. F. Bowen Jr., advertising director.

CONSOLIDATED BALANCE SHEET JANUARY 31, 1965

ASSETS

CURRENT ASSETS:		
Cash (including certificates of deposit, $3,400,000)		$ 12,988,299
Accounts receivable:		
Customers' accounts and equity in installment accounts sold (Note 2)	$ 930,910	
Other	2,383,295	
	3,314,205	
Less reserves	1,521,808	1,792,397
Merchandise inventories, at lower of cost or market		86,293,802
Prepaid expenses, etc.		2,128,655
TOTAL CURRENT ASSETS		103,203,153
INVESTMENT IN GLEN ALDEN CORPORATION, at cost (Note 3)		34,258,246
PROPERTY AND EQUIPMENT, at cost:		
Store properties and warehouses	13,368,809	
Furniture and fixtures and improvements to leased property	137,788,255	
	151,157,064	
Less accumulated depreciation and amortization	79,492,914	71,664,150
OTHER ASSETS:		
Excess of purchase cost of Lerner Stores Corporation common stock over underlying net equity at dates of acquisition (Note 4)	17,075,188	
Unamortized debt expense	7,531,008	
Investment in and advances to subsidiary not consolidated (Notes 1 and 2)	5,818,216	
Mortgages and sundry receivables (Note 12)	2,450,995	
Goodwill, less amortization of $326,047	1,026,580	
Deferred charges	1,615,492	35,517,479
TOTAL		$244,643,028

See notes to financial statements.

LIABILITIES AND SHAREHOLDERS' EQUITY

CURRENT LIABILITIES:		
Current maturities of long-term debt (Note 5)		$ 12,800,395
Accounts payable		20,890,953
Accrued expenses and sundry liabilities		13,770,467
Accrued Federal income taxes		2,635,000
TOTAL CURRENT LIABILITIES		50,096,815
LONG-TERM DEBT, less current maturities (Note 5)		67,124,686
OTHER NONCURRENT ITEMS:		
Deferred Federal income taxes (Note 6)	$ 10,489,541	
Reserve for the closing or sale of loss stores and discontinuance of credit service (Note 7)	1,303,572	
Other	258,461	12,051,574
MINORITY INTEREST IN SUBSIDIARY COMPANY		1,758,893
SHAREHOLDERS' EQUITY (Notes 5, 8 and 9):		
Preferred stock, cumulative, $100 par value, series issue, authorized 34,791 shares—		
3½% series cumulative convertible, authorized and outstanding 14,791 shares	1,479,100	
$6.00 cumulative convertible preference stock, $100 par value—authorized 95,695 shares, outstanding 94,725 shares	9,472,500	
Preference B stock, $100 par value, series issue, authorized 187,906 shares—		
5½% series, cumulative (subordinated and convertible), authorized and outstanding 11,871 shares	1,187,100	
4½% series, cumulative (subordinated and convertible), authorized 130,079 shares, outstanding 124,641 shares	12,464,100	
Common stock, $.50 par value—authorized 15,000,000 shares, issued 5,977,367 shares	2,988,683	
Capital surplus	39,098,719	
Earned surplus	61,438,766	
	128,128,968	
Less—748,500 common shares of treasury stock, at cost	14,517,908	113,611,060
TOTAL		$244,643,028

See notes to financial statements.

STATEMENT OF CONSOLIDATED INCOME

FOR THE YEAR ENDED JANUARY 31, 1965

NET SALES—Merchandise, restaurant and concession		$547,432,672
Cost of goods sold, buying and occupancy expenses, net of service charge income	$397,768,567	
Selling, general and administrative expenses	122,573,685	520,342,252
OPERATING PROFIT BEFORE DEPRECIATION AND AMORTIZATION		27,090,420
Depreciation and amortization		8,606,554
OPERATING PROFIT		18,483,866
Other expenses (net):		
Interest	6,151,524	
Amortization of debt expense	866,696	
	7,018,220	
Less—Investment income, earnings of subsidiary not consolidated (Note 1), and miscellaneous income (net)	2,076,231	4,941,989
PROFIT BEFORE PROVISION FOR FEDERAL INCOME TAXES		13,541,877
Provision for Federal income taxes (Note 6)		4,876,000
NET INCOME (Note 11)		$ 8,665,877

See notes to financial statements.

STATEMENTS OF CONSOLIDATED SURPLUS

FOR THE YEAR ENDED JANUARY 31, 1965

	EARNED SURPLUS	CAPITAL SURPLUS
BALANCE, February 1, 1964	$63,524,752	$39,094,164
ADD (DEDUCT):		
Net income (Note 11)	8,665,877	
Dividends paid during year:		
Common stock ($.80 per share)	(4,174,283)	
3½% series, cumulative convertible preferred stock ($3.50 per share)	(51,770)	
$6 cumulative convertible preference stock ($6.00 per share)	(568,350)	
5½% series, cumulative (subordinated and convertible) preference B stock ($5.50 per share)	(65,290)	
4½% series, cumulative (subordinated and convertible) preference B stock ($4.50 per share)	(561,982)	
Dividends on preferred stock of Lerner Stores Corporation	(59,635)	
Total dividends	(5,481,310)	
Charge to establish a reserve for the closing or sale of loss stores and discontinuance of credit service, net of estimated Federal income tax benefit (Note 7)	(3,500,000)	
Provision for estimated additional taxes and other adjustments applicable to prior years (Note 12)	(2,174,348)	
Estimated recovery in settlement of certain legal actions, less related legal expenses (Note 12)	575,000	
Excess of cost of 22,886 shares of treasury stock issued under stock option plans over option price (Note 9)	(175,418)	
Other—net	4,213	4,555
BALANCE, January 31, 1965	$61,438,766	$39,098,719

See notes to financial statements.

NOTES TO FINANCIAL STATEMENTS, JANUARY 31, 1965

(1) Principles of consolidation:

The accompanying consolidated financial statements as of January 31, 1965, reflect the consolidation of the accounts of Lerner Stores Corporation (whose common stock is 99% owned) and all wholly-owned subsidiaries except McCrory Credit Corporation. The investment in the credit subsidiary not consolidated is stated in the accompanying consolidated balance sheet at the amount of the Company's equity in the capital and undistributed earnings ($918,528) of such subsidiary at January 31, 1965. Net income ($365,088) of the nonconsolidated credit subsidary for the year ended January 31, 1965 is included in the McCrory consolidated net income for that period. (See Note 2 for additional information on McCrory Credit Corporation.)

(2) Equity in installment accounts sold:

The companies have financing agreements with McCrory Credit Corporation (see following paragraph) under which certain customers' accounts receivable created each month are assigned to McCrory Credit Corporation. The latter remits 90% of the amount of accounts assigned, the remaining 10% representing the companies' equity therein. The companies accept reassignment of any accounts in default, as defined. The companies' equity in assigned accounts receivable (the uncollected balances of which amount to $27,502,000 at January 31, 1965) is included in accounts receivable in the accompanying consolidated balance sheet. Collections in January 1965 (payable to McCrory Credit Corporation in February 1965) from assigned customers' accounts (net of 10% equity) amounting to $7,329,000 have been deducted from accounts receivable in the accompanying consolidated balance sheet.

McCrory Credit Corporation, a wholly-owned subsidiary of McCrory Corporation, was organized to (a) accept the assignment of accounts receivable from McCrory Corporation and subsidiaries and affiliates as outlined in the preceding paragraph and (b) through a separate leasing subsidiary, to acquire equipment for lease to the McCrory-McLellan-Green Stores Division of McCrory Corporation under a 15 year lease agreement. At January 31, 1965 the credit corporation and its subsidiaries had invested $27,560,000 in accounts receivable of McCrory Corporation and subsidiaries and affiliates and an additional $1,325,000 in equipment purchased for rental. Financing of the foregoing had been provided principally from (1) $1,000,000 of equity funds and $4,000,000 in subordinated loans from McCrory Corporation and subsidiaries, (2) $22,000,000 in 4½% bank loans on unsecured notes of the credit corporation, and (3) a 5½% chattel mortgage with a balance of $1,286,000 at the year end.

(3) Investment in Glen Alden Corporation:

During the year ended January 31, 1965 McCrory acquired 2,388,230 common shares of Glen Alden Corporation for cash and notes payable. These shares represent 49.7% of the outstanding common shares of Glen Alden Corporation at January 31, 1965 and had a market quotation value of $28,957,289 at that date and $32,838,163 at March 23, 1965. McCrory's equity in the net assets of Glen Alden Corporation based on its financial statements as of December 31, 1964 was $844,290 in excess of the cost of the investment. Dividends of $674,073 received in January 1965 from Glen Alden have been included in investment income in the accompanying statement of consolidated income.

(4) Excess purchase cost of Lerner Stores Corporation common stock:

During 1961 and 1962, McCrory acquired 1,263,617 shares (99% ownership as of January 31, 1965) of Lerner Stores Corporation common stock principally as the result of a tender offer made on August 10, 1961. The aggregate cost of the investment in Lerner exceeded the McCrory equity in underlying Lerner net assets at dates of acquisition by $17,075,188. This excess purchase cost has been recognized by the McCrory management to be similar in nature to intangibles which have not declined in value since date of acquisition. Accordingly, the McCrory management has adopted an accounting policy of not amortizing this excess purchase cost, so long as there is no recognized diminution in value of its investment in Lerner.

(5) Long-term debt:

Long-term debt at January 31, 1965, including maturities due within one year, consisted of the following:

	Total	Current Maturities	Long-Term Debt
5½% sinking fund subordinated debentures, due 1976 (a)	$36,040,960		$36,040,960
5.235% subordinated notes, due in equal annual installments to 1971	12,503,991	$ 1,786,284	10,717,707(d)
5% junior subordinated notes, maturing serially from April 1, 1965 to April 1, 1970 (b)	24,144,008	10,411,685	13,732,323(d)
3% sinking fund debentures, due July 1, 1967(c)	3,275,000	75,000	3,200,000
Mortgages payable	2,230,431	125,446	2,104,985
3¾% notes, due in annual installments to 1966	203,000	104,000	99,000
4% notes, paid March 17, 1965	198,000	198,000	
Sundry	1,329,691	99,980	1,229,711
Total	$79,925,081	$12,800,395	$67,124,686

(a) Exclusive of $831,104 redeemed and cancelled which is available for 1968 sinking fund payment. Sinking fund requirements in each year are as follows: 1968 through 1971 — $2,048,448; 1972 through 1976 — $3,277,517, with a final payment of $12,290,687 due on August 15, 1976.

(b) Exclusive of $335,350 in treasury.

(c) Exclusive of $525,000 in treasury. Sinking fund requirements are $600,000 in each year to 1966 and $2,600,000 at maturity.

(d) By notices dated March 1 and 8, 1965, McCrory Corporation called for redemption on March 30 and April 1, 1965, $5,368,630 of the foregoing debt which is classified as long-term at January 31, 1965. The $5,368,630 has been retained in long-term debt at January 31, 1965 since it is management's intention to pay such debt by utilization of long-term borrowings.

Agreements covering certain long-term indebtedness of McCrory contain covenants concerning working capital position, additional indebtedness, limitations on the declaration and payment of dividends, restrictions on transactions in capital stock, etc. At January 31, 1965 the most restrictive of such covenants were met as follows:

(i) Consolidated working capital (as defined) which amounted to $54,014,870 must be maintained at least equal to $36,040,960.

(ii) Consolidated current assets (as defined) were 210% of consolidated current liabilities (as defined) as compared to the 175% requirement.

(iii) Consolidated indebtedness (as defined) of $42,674,656 which should not be in excess of 50% of consolidated net worth (as defined) was $15,010,320 less than the maximum indebtedness allowed.

(iv) Consolidated net worth (as defined) was $115,369,953 as compared to the $90,000,000 requirement.

At January 31, 1965, approximately $17,975,000 of consolidated surplus was free of restrictions.

The aggregate of long-term debt maturing during the five years ended January 31, 1970 is approximately as follows: 1965, $12,800,000 (included in current liabilities); 1966, $10,455,000; 1967, $8,133,000; 1968, $4,299,000; and 1969, $5,296,000.

(6) Federal income taxes:

The provision for Federal income taxes is based upon the Company's filing a consolidated Federal income tax return and has been reduced by a carry-forward consolidated operating loss and an investment tax credit. At January 31, 1965, the companies have an unused investment tax credit of approximately $900,000.

For Federal income tax purposes accelerated methods of computing depreciation and the installment method of reporting certain sales have been availed of. The use of these methods has resulted in tax deferrals which have been charged against income and credited to deferred Federal income taxes.

(7) Reserve for the closing or sale of loss stores and discontinuance of credit service:

On May 28, 1964 the McCrory Board of Directors established

through a charge of $3,500,000 (net of estimated Federal income tax benefit) to earned surplus, a reserve for losses principally inherent, although not yet realized, in the planned termination of operations of loss stores and discontinuance of credit service at certain stores. In the year ended January 31, 1965, charges totaling $2,196,428, net of Federal income taxes, were made to this reserve.

(8) Preferred and preference stock and warrants:

At January 31, 1965, there were 522,915 shares of common stock reserved for the conversion of preferred and preference stock, as follows:

Class of Stock	Redemption Price	January 31, 1965 Conversion Rate Common Shares For Preferred or Preference	Shares of Common Stock Reserved
3½% cumulative convertible preferred	$104	5 for 1	73,955
$6 cumulative convertible preference	115	3/14 for 1	20,298
5½% cumulative preference B	100	6-1/9 for 1	72,545
4½% cumulative preference B	100	2-6/7 for 1	356,117
Total			522,915

In addition, 2,673,467 shares of common stock were reserved for the exercise, at $20 per share, of warrants (expiring in 1976) issued in connection with the 1961 merger of H. L. Green and the 1961 purchase of Lerner stock.

Pursuant to certain restrictions in connection with the authorization of preferred stock, earned surplus at January 31, 1965 in the approximate amount of $1,540,000 is restricted as to future payments of dividends on the common stock or purchase or redemption of shares of McCrory's stock.

(9) Stock option and employee stock purchase plans:

Under the Company's restricted stock option plans adopted during 1960 and 1961, options for 490,700 shares of common stock were outstanding at January 31, 1965 at prices ranging from $11.91⅓ to $22.80 per share (375,700 shares at 95%, and 115,000 shares at 100%, of fair market value on dates of grant), of which 304,920 shares were exercisable at that date. During the year ended January 31, 1965, options for 104,070 shares became exercisable; 9,060 shares were exercised at an aggregate option price of $111,722; options to purchase 115,000 shares at $12.25 a share were granted; and, options for 407,200 shares were cancelled. At January 31, 1965 526,820 shares remain available for future option grants under these plans. It is contemplated that, if the 1964 qualified stock option plan of the Company noted below is approved by stockholders, no future options will be granted under the aforesaid plans.

Options granted under the aforesaid plans are exercisable for a maximum of ten years. Options generally become exercisable to the extent of 20% each year on and after the anniversary dates of the grants with respect to the 1960 plans, and 20% each year on and after the second anniversary dates of the grants with respect to the 1961 plan. Options may not be sold, transferred, assigned, pledged or disposed of by the grantee except by will or laws of inheritance. In the event of termination of employment by resignation, disability or death, all options will expire within varying periods up to the full term of such options.

A qualified stock option plan adopted during 1964, subject to stockholders' approval, authorized the grant to officers, other executive and key employees of options to purchase up to 750,000 shares of common stock at 100% of the fair market value on the dates of grant. Options to purchase 389,300 shares have been issued under this plan (including options to purchase 1,200 shares cancelled) at prices ranging from $13.125 to $14.50 a share. At January 31, 1965, options as to 388,100 shares were outstanding, of which 96,023 shares, subject to stockholders' approval of the plan, were exercisable at that date; 361,900 shares remain available for future option grants under this plan.

Options granted under the aforesaid plan are exercisable for a maximum of five years. Options become exercisable, on a cumulative basis, in installments of 25% each at intervals of 6, 15, 24 and 33 months after the date granted. Options may not be sold, transferred, assigned, pledged or disposed of by the grantee except by will or laws of inheritance. In the event of termination of employment by resignation, disability or death, all options will expire within varying periods up to six months from such termination.

The option granted by McCrory on January 31, 1964 to a key employee to purchase 15,000 shares of its common stock held in the treasury, at a price of $13.50 per share, was cancelled on July 1, 1964.

Employee stock purchase plans adopted during 1960 and 1961 permit the grant of rights to purchase a total of 190,000 shares of common stock at 85% of the fair market value thereof on the dates of grant. Rights to purchase 13,826 shares were exercised during the year at an aggregate purchase price of $159,209, and at January 31, 1965, 14,533 shares were under subcription at prices ranging from $10.63 to $14.24. No additional rights will be issued under the aforesaid stock purchase plans.

(10) Pension plans:

Under the Company's noncontributory retirement plan covering eligible employees of the McCrory-McLellan-Green Stores Division, the cost of the plan will be met, as required, by periodic contributions to the trust fund. The amounts accumulated in the trust fund in respect of the McCrory-McLellan-Green plan, exceed the actuarial liability as computed by the consulting actuary. For this reason, no provision for costs under this plan was reflected in the statements of consolidated income subsequent to 1960. Contributions of $1,000,000 made under other noncontributory retirement and profit sharing plans, principally for employees of Oklahoma Tire and Supply and Lerner Stores Corporation, paid or accrued during the year, have been reflected in the accompanying statement of consolidated income.

(11) Net income and earned surplus:

The charge to establish a reserve for the closing or sale of loss stores and discontinuance of credit service ($3,500,000), provision for estimated additional taxes and other adjustments applicable to prior years ($2,174,348), and estimated recovery in settlement of certain legal actions, less related legal expenses ($575,000) included in the accompanying statement of consolidated earned surplus are being set forth as special items following net income in reports filed with the Securities and Exchange Commission.

(12) Other matters:

Federal income tax returns of Lerner Stores Corporation and subsidiaries for the fiscal years ended in 1958, 1959 and 1960 have been examined by the Internal Revenue Service and there has been tentative agreement with the Internal Revenue Service regarding settlement of the outstanding issues. The companies have provided, by a charge of $2,200,000 (McCrory's equity therein is $2,174,348) to earned surplus, for the estimated effect of such tentative agreements, together with provisions for other taxes and adjustments which relate to prior years.

In January 1965, Rapid-American Corporation agreed to the proposed settlement of certain derivative actions, including those pending in the New York County Supreme Court, subject to review and approval of that Court, by payment to McCrory Corporation of $800.000. Such payment, at the option of Rapid, may be made in cash or in McCrory Corporation common stock or in both. The amount of the proposed settlement, less estimated legal expenses of $225,000, has been credited to earned surplus. The $800,000 receivable from Rapid is included in mortgages and sundry receivables in the accompanying consolidated balance sheet.

There are several claims pending against McCrory Corporation and subsidiaries together with other contingencies. Such liability cannot be determined but management and counsel are of the opinion that the liabilities in the accompanying consolidated financial statements are adequate to cover all eventual payments.

At January 31, 1965, the minimum annual rentals upon property leased to the Company and its subsidiaries under leases expiring after January 1968, amount to approximately $22,100,000 plus, in certain instances, real estate taxes, insurance, etc. The Company remains contingently liable under certain long-term leases assumed by the respective purchasers in connection with several sales of store operations, particularly with respect to those of Butler Brothers and Metropolitan Stores, sold in prior years. However, the Company has in most cases received from the purchasers valid and enforceable agreements of assumption of liabilities and indemnification in form satisfactory to counsel for the Company.

On March 17, 1965, an interest of approximately 19% in the common stock of S. Klein Department Stores, Inc. was acquired by Lerner Stores Corporation at a cost of approximately $3,350,000.

ACCOUNTANTS' OPINION

McCrory Corporation:

We have examined the financial statements of McCrory Corporation and subsidiary companies except Lerner Stores Corporation and its subsidiaries for the year ended January 31, 1965. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. As to Lerner Stores Corporation and its subsidiaries, we were furnished with the report of other accountants on their examination of the financial statements of that company and its subsidiaries for the year.

In our opinion, based on our examination and the report of other accountants referred to above, the accompanying consolidated balance sheet and statements of consolidated income and surplus present fairly the financial position of McCrory Corporation and subsidiary companies at January 31, 1965 and the results of their operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

New York, N. Y.
March 23, 1965

HASKINS & SELLS
Certified Public Accountants

McCRORY CORPORATION AND SUBSIDIARY COMPANIES
GENERATION AND APPLICATION OF FUNDS
FOR THE YEAR ENDED JANUARY 31, 1965

Cash Generated from Operations:		
Net Income		$ 8,666,000
Expenses which did not involve working capital:		
Depreciation and amortization		9,473,000
Provision for deferred Federal income taxes		3,906,000
Other		203,000
Total Cash Generated from Operations		$22,248,000
Application of Funds:		
Purchase of Glen Alden Corporation common shares (less amounts which did not require working capital)	$20,526,000	
Dividends paid	5,481,000	
Additions to property and equipment	4,751,000	
McCrory's equity in estimated additional taxes and other adjustments applicable to prior years	2,174,000	
Charges to reserve for closing or sale of loss stores and discontinuance of credit service	2,025,000	
Reduction of long-term debt—net	2,564,000	
Purchases of capital stock	157,000	
Other—net	52.000	
Total Funds Applied	37,730,000	
Less Funds From Other Sources:		
Proceeds from sale of property and equipment	1,107,000	
Sale of common stock	272,000	
Decrease in net working capital	14,103,000	
	15,482,000	
Net Funds Applied		$22,248,000

GLEN ALDEN CORPORATION

As indicated in an earlier section of this report, McCrory purchased 49.7% of the outstanding common stock of the Glen Alden Corporation during the latter part of 1964 and early 1965.

The Glen Alden board was expanded and Meshulam Riklis, McCrory's chairman, was elected vice chairman of the Glen Alden board. The following McCrory directors were added to the Glen Alden board: Messrs. Isidore A. Becker, Harold M. Lane Sr., Leonard C. Lane, Samuel J. Levy, Samuel Neaman, Gilbert H. Perkins and Bert R. Prall.

Glen Alden is a diversified company whose securities are traded on the New York Stock Exchange. It consists of Glen Alden Coal Company, RKO Theatres, Swift Manufacturing Company and Opp and Micolas Cotton Mills.

Comparative Highlights

	1964	1963
Net sales and revenues	$98,621,000	$118,765,000
Income before depreciation, depletion and amortization	12,569,000	11,234,000
Net income from operations	6,000,000	7,898,000
Non-operating items	3,777,000	——
Total net income	9,777,000	7,898,000
Cash	37,821,000	12,895,000
Net working capital	41,103,000	29,670,000
Current ratio	4.8 to 1	2.5 to 1
Book value of shares	70,595,000	74,095,000
Book value per share	14.72	13.47

S. KLEIN DEPARTMENT STORES, INC.

McCrory Corporation now owns approximately 19% of the total stock outstanding of S. Klein Department Stores, Inc., as indicated in an earlier section of this report.

S. Klein, founded 59 years ago, is one of the pioneers in the department store discount field. The company operates ten stores located in: New York City, Yonkers, Hempstead and Commack, New York; Newark and Woodbridge, New Jersey; Philadelphia and Marple, Pennsylvania; Greenbelt, Maryland and Alexandria, Virginia (Washington, D.C. trading area).

Under the company's expansion program, the total selling area increased from 910,000 square feet in 1962 to 2,060,000 square feet at the end of fiscal 1964.

Sales increased to $172,181,798 for the fiscal year ended July 25, 1964, against $140,030,647 for the fiscal year 1963. Net profits were $386,902 (inclusive of a non-recurring profit net of taxes from a lease cancellation in the amount of $395,771) compared to net profits after taxes of $331,375 for the prior year. The 1964 earnings included $791,000 of new store pre-opening expenses which are expected to be reduced to $375,000 in fiscal 1965.

For the 26 weeks ended January 23, 1965, the company achieved net income of $969,989 on gross revenues of $103,345,796. For the 25 week period ended January 18, 1964, the company had net income of $228,453 (exclusive of a special credit, net of taxes, in the amount of $372,025) on gross revenues of $88,430,891. Klein's securities are listed on the American Stock Exchange.

RAPID-AMERICAN CORPORATION
711 FIFTH AVENUE, NEW YORK, N.Y. 10022